RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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**Aug. 4, 1993** **LETTER 1127**

**JOBS, JOBS:** Right, but now we're talking about Congressional jobs. Some of the Democrats in Congress, sensing the disastrous implications of Clinton's so-called "Deficit Reduction Bill," are threatening to vote "No." Since the head-count in favor of the bill is already super-slim, any switch on the part of Dems could sink the whole program. Russell opinion: Killing this rotten bill would be bullish for the economy, but bearish overall in that Clinton would then be literally a "lame duck" president, a president without a program.

**THE PICTURE:** One by one, like ducks being bowled over in a shooting gallery, they're killing the great stocks of America. But wait, please, not Microsoft, not the company founded and controlled by Bill Gates, America's boy-wonder billionaire. Sorry, but it's true -- even MSFT has been hit. Let's face it, we're looking at "the bull market with no mercy," the bull market that has whacked Apple, IBM, Merck, Borden, Procter, Wal-Mart, Glaxo, Chemical Waste and dozens, no hundreds, of other Wall Street darlings.

But enough of the sarcasm. What's really happening? I said it in the last Letter, but I want to repeat it. A huge number of stocks are now highly interest rate-sensitive. These include the bank stocks, the utilities, the S&Ls, the finance stocks, the brokerage stocks and particularly the many preferred stocks and closed-end bond funds. Put them all together, and you're talking about 38% of ALL the stocks on the NYSE. Bolstered by persistently lower interest rates, these are the stocks that have been levitating the market.

This bull market is tired, but it's being boosted by (1) the lowest interest rates in 20 years, and (2) persistent buying of mutual funds by a public that believes that owning funds is the only way to obtain income in a world of 2.7% T-bills and 3% CDs.

There's no question about it -- the financial phenomenon of the '90s has been the mutual funds (today, there are a fantastic 4,000 of them). Money has been pouring into the equity mutual funds at a rate of around 10 billion dollars a month. Any way you look at it, this is BIG money. And the great portion of this new money is immediately thrown (pardon me, invested) in the stock market. The funds managers feel justified in keeping 90% or more of their funds in stocks, justified on the basis of "Hey, you didn't buy my fund to be in dollars, you bought my fund to be in the stock market."

Professional traders love high volatility (major movement either up or down). Last year we saw the lowest stock market volatility in history (i.e., little movement). But this year volatility could be even lower. HOWEVER, like the weather, the stock market tends to be "calm before the storm." I don't know whether the coming storm will be bullish or bearish for the market -- but it's coming, it's coming.

PRICE ACTION: The stock market continues to act erratically with first the Dow up (new highs) and the Transports down, then the Transports down and the Dow up. I call this the "drunken sailor" syndrome; it's symptomatic of a market that isn't certain of where it wants to go. Selectivity rules with individual stocks reacting violently to news. Poor earnings can drop a stock 20% at the opening and good earnings can do the same on the upside. When markets react that violently to news, it smacks of amateur anxiety and professional frantic-ness. With thousands of funds vying to

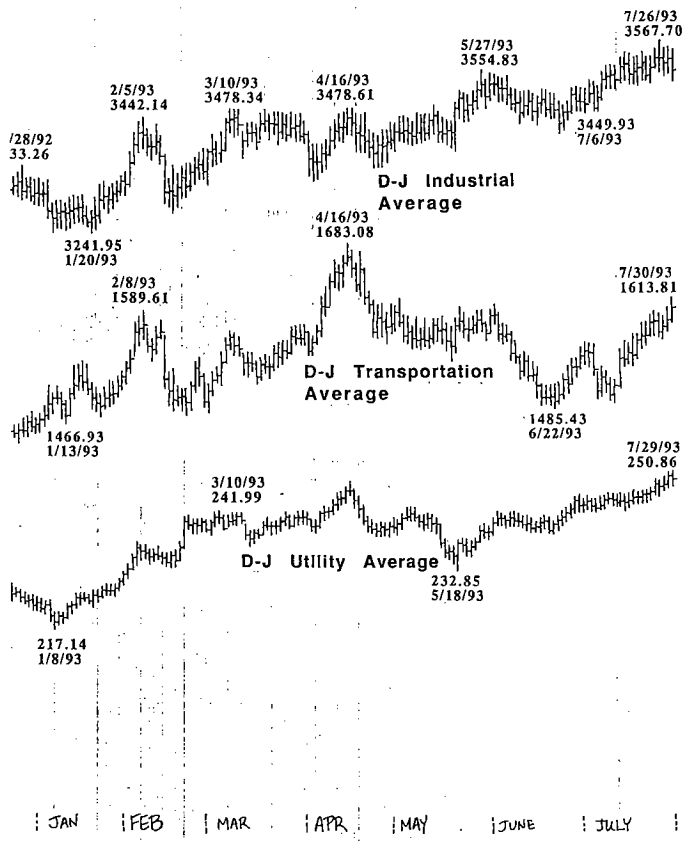
**July 23 DJIA 3546.74; PTI 3874; A-D Ratio -4.28**
**July 30 DJIA 3539.47; PTI 3880; A-D Ratio -4.04**
**Dow Yield: 2.88%; Dow Price/Earnings: 41.1**
**Dow 200-day MA: 3382; Dow 30-day MA: 3514**
**Dow Times Book Value: 2.71; PTI 89-day MA: 3823**
**Percentage of Undervalued Blue-chips: 7%**
**Low Risk Buy Index: +61**

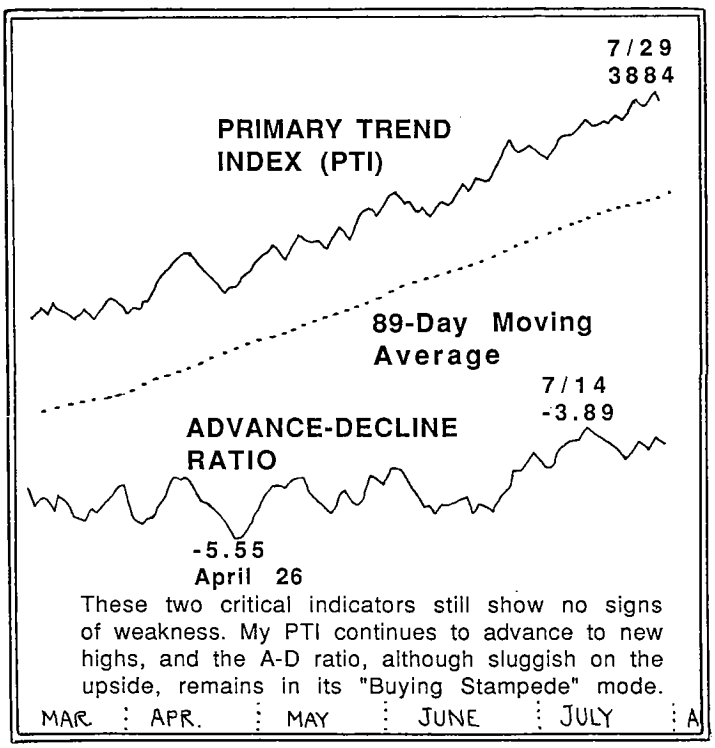
"beat the averages," the competition to be in the "right" stocks is intense.

Meanwhile, my Primary Trend Index (PTI) continues to hit new highs, confirmed by new highs in the advance-decline ratio. INCREDIBLY, the "buying stampede" which I have written so much about is still (after nine months) in force. Frankly, in all the years I've been watching markets I can't remember seeing anything like this action.

Today, with the P/E for the S&P 500 well above the rarefied 20 level, we can only wonder what the market has in store for us. So far, it's been the smashing of a selected list of stocks, some well-known and some not. I've labeled this market, *"The bull market with no mercy."* However, the weakness in individual stocks has been covered up by strength in selected Dow stocks and by revolving strength in selected stock groups.

With the continuing strength in my PTI and with the Buying Stampede still in force, you have to wonder what this market has in store for us. Is there to be a final upthrust for the bull, or is the bull market simply fated to fade away? I wish, I wish, I wish I knew.






These two critical indicators still show no signs of weakness. My PTI continues to advance to new highs, and the A-D ratio, although sluggish on the upside, remains in its "Buying Stampede" mode.

**INVESTMENT POSITION:** Julian Snyder thinks there's going to be one final inflationary blow-off, before this bull market breathes its last. Bob Prechter thinks the Dow could muster up one final push to 3600-3700 before the worst bear market of the century takes place. John Templeton, the great mutual fund maven, thinks that many stocks (particularly selected foreign stocks) still represent good value, and he further feels that there's too much pessimism here for a bear market to start.

At this point, I'm neutral or "open to suggestions" on how we go from here. As noted, a broad spectrum of stocks have already been torn apart. This alone has generated a good deal of pessimism on the part of investors, as well it should. Listen, if you put $25,000 into stocks or mutual funds last January and that twenty-five grand is worth maybe $21,000 today, then I don't care what John Templeton or Alan Greenspan or anyone else says, you're not going to be thrilled.

Actually, the happiest chain of events that could occur (from a business and investment standpoint, of course) is that Rostenkowski loses his job, key Democrats revolt, the Clinton so-called "deficit reduction program" fails to pass -- and last but not least, it finally dawns on our populist President that "soaking the rich" is not the path to prosperity in America.

One thing is clear. The world may be in the grip of deflationary forces, but the central banks of the world are pumping, they've got "the pedal to the metal." This is creating a SEA OF LIQUIDITY, with more on the way. So far the liquidity has been washing over the stock and bond markets, and it is about to spill over into the tangible markets. My feeling is that the big profits ahead lie with the tangibles, and the "king of tangibles" is gold.

Consequently, I've cleaned out most of my common stocks with the exception of my gold shares (and believe me, I'm loaded with these). The talk I'm hearing is that "this is just an isolated surge in gold, based on chaos in the European currency markets." Forget it -- this gold bull market started way before the mess in the Europe. Chaos in Europe may inflame the gold advance, but the fundamentals of the gold bull market entail a lot more than an attack by FOREX traders on the French franc or even a bust-up of the ERM.

**MONEY:** With crude oil sinking down to 18 dollars a barrel, with no obvious inflation in the air, people are wondering why gold has climbed up into the 390 to 400 area.

The answer is that the world's currencies, one by one, are falling by the wayside. Spain has devalued three times this year and is contemplating a fourth devaluation. Portugal has devalued. Ireland has devalued. Britain and Italy have quit the European Rate Mechanism (ERM). The Chinese yuan has been crushed as has the Russian ruble. More recently, the Foreign Exchange (FOREX) traders have been attacking both the Danish krona and the French franc.

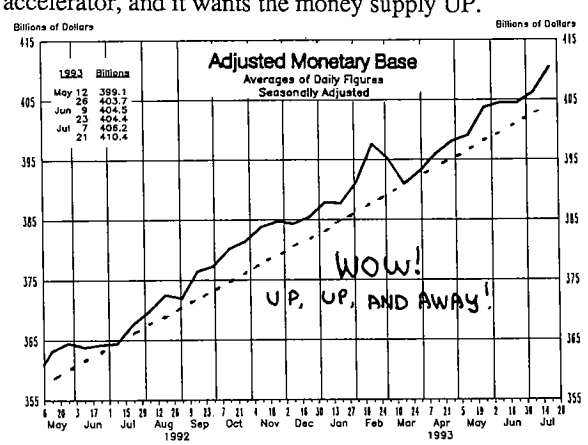
When a currency is attacked (sold by the FOREX traders), one way of defending it is to raise interest rates, thereby making the currency more attractive to hold. The Danes have already raised their rates. France has raised its overnight bank rate to 10%. But for France, it will not be that easy. France has a severe problem -- an unemployment rate of 11.5%, so to raise the discount rate would be politically impossible. But the French relationship to the D-mark is crucial for the continued existence of the ERM. If the French franc falls, the ERM dream of a single European currency will go up in smoke.

The FOREX traders know that France will resist raising its rates. Therefore, the franc is vulnerable. To defend the franc, the Bundesbank (aside from intervening by buying the franc, which they've been doing) can lower its own rates, thereby making the D-mark less attractive in relation to the franc. German bonds, sensing the coming decline in D-mark rates, have rallied strongly.

I've said this before, but I'll repeat it -- the great economic Long Wave has turned down. And the governments of the world are beginning to feel it. Therefore, as global unemployment rises and as the world's debt sky-rockets upwards, the various central banks are being placed under extreme pressure.

Action by the central banks is the one real alternative to recession or depression. In other words, the banks must inflate. And that's exactly what they're doing. Central banks must move to stimulate their respective economies, and if stimulation means inflating their money supplies (which will later show up in inflated prices of goods), so be it.

Fed Chairman Greenspan may mumble his worries about inflation before Congress, but it isn't what the Fed Chairman says, it's what the Fed does. And here's what the Fed is doing. This chart (courtesy of the *St. Louis Federal Reserve)* shows that the Adjusted Monetary Base is expanding at double-digit rates. The major source of the Adjusted Monetary Base is Federal Reserve Credit. Believe me, the Fed's got its foot on the monetary accelerator, and it wants the money supply UP.



All this is not lost on gold. Despite lower oil prices, despite the still low level of commodities, despite the deflationary tendencies in the US economy, somebody out there is buying gold. Somebody bought all the gold sold earlier in the year by the central banks, somebody bought gold off the bottom at 327, and somebody has been buying gold ever since.

There's an excellent new book out in paperback entitled, "*Getting Rich Outside the Dollar*" (by Christopher Weber and Leonard Reiss, Warner Books). I highly recommend this very informative 350-page book. Among other things, the book recounts the history of all the major currencies, and it's a fascinating history.

One of the items underscored in the book is how far the dollar has fallen (since WWII) against some of the major currencies such as the D-mark, the Swiss franc and the yen. The history of the dollar is that it has lost value against most of the major currencies For instance, since WWII the yen has appreciated over 600% against the dollar

In 1951 the D-mark hit an all-time low. At that time each mark was worth 12.4 cents. Forty years later, in 1991, the mark rose to a high of 69 cents. Since then, amid Germany's severe reunification problems, the mark has dropped to 58 cents. But older Germans have seen their currency totally wiped out twice, and their cry is "never again." Which is the reason why the Bundesbank assumes such a tough stance against inflation. By law, the German bank must defend the value of the currency.

The US Federal Reserve was modeled after the European central banks. The creation of the Fed came as an aftermath of the stock market "Panic of 1907." After that horrendous stock market and business collapse, certain banking elements decided that it was time to act. They convinced America's money-ignorant politicians that America needed a central bank, a bank that could expand or contract the money supply at will and as needed. In 1913 (amid an unbelievable amount of finagling) the Federal Reserve Act was passed.

Although the US Constitution expressly prohibited any but the federal government from issuing money, the Constitution was subverted, and the Federal Reserve was born (note that the bankers avoided calling it a central bank).

At any rate, the creation of money was then taken out of the hands of the US government and put in the hands of private banks. But one other item stood in the way of the banks' free creation of fiat "money." That was the fact that the dollar was backed by (tied to) gold.

In 1933 the Roosevelt administration moved to prohibit Americans from owning gold. Then in the early 1970s the law was changed and Americans were allowed to own gold. But in 1971 Nixon slammed down the gold window to foreigners. Due to the rapid outflow of US gold, the US in 1971 announced that it would no longer allow our foreign creditors to call in US gold against their debts.

This effectively ended any tie, domestic or foreign, between gold and the dollar. The dollar became a complete fiat currency, it was simply legal tender for payment of all debts -- by order of Congress.

There now exists no definition of a dollar. A dollar is simply worth this much against the mark or so much against the yen -- thus the dollar's relative value changes from hour to hour. Currently the dollar possesses no anchor in either gold or silver. It's a totally floating currency.

So at this point the game is trading, trading the strongest or weakest currency. If you think the D-mark is going to be strong against the dollar, buy the D-mark. If the Danish krona is heading into the basement, sell the krona. As for the FOREX traders (and many banks now trade the currencies), they love floating currencies and they love volatility. Trading the currencies is how they make their living. As for the possible death of the ERM, the FOREX traders would love it. The more currencies out there to trade, the better they like it.

Of course the ultimate winner will be the only real money -- gold. In the end, all the world's currencies are measured by how many ounces of gold they will buy. The politicians hate that idea, the central banks (although they hold gold as their ultimate reserve) hate that idea.

Why do they hate gold? Because ultimately, gold possesses the real power -- gold is stronger than paper, and it's more powerful than the central banks. Let me put it this way -- for 5,000 years gold has retained its purchasing power. But sooner or later every paper currency has been devalued into worthlessness. Why do currencies die? Because when the economic or political pressure is on, politicians turn to inflation. Inflation, the degeneration of a currency, it's the easy way to fire up the economy, and it's the easy way to destroy debt.

How does inflation destroy debt? Simple, it destroys the paper money that the debt is denominated in. Example: if the US government now has $4 trillion in debt (which is the case), at 5% inflation that $4 trillion will be worth only $2 trillion in a matter of 14 years. In the end politicians find that inflation is far less painful than paying off debt. And as for America's politicians, they find that spending three dollars for every two they take in is more fun than dealing with a balanced budget.

**JULIAN:** I took over Julian Snyder's market letter some years ago. I still have a great many former Julian Snyder subscribers (he was the brilliant publisher of *International Moneyline*). Julian now puts out a private letter at *PO Box 70, 7500 St. Moritz, Switzerland.* What's Julian thinking? Fresh from a trip to Singapore, Malaysia and Kuala Lampur, Julian writes, "You can almost feel the beat of Asia's rapid economic pulse . . . I can say with conviction: I have seen the future and it's Asia, even though I have yet to visit mainland China, which looms over Asia like a gigantic, waking dragon, breathing economic fire and smoke." Julian believes, as I do, that inflation is the wave of the future. He continues, "We are now deep in the downswing phase of the Long Wave . . . We are also reaching the end of a Grand Supercycle which began around 1789. In my view the crash of '29 and '87 were merely warning signs of the great debacle to come . . . What I now see ahead . . . is an amazing final end of the 20th century boom period that nobody expects. The boom will be triggered by an increasingly rapid depreciation of all currencies as the central bankers 'print money,' as Asia flourishes and consumerism has its last great fling . . . Once again Armageddon has been postponed." Note that Julian thinks the end will be postponed, not avoided. Julian likes gold and considers it a long-term holding. "If you bought gold for cash," he writes, "hold your position and add to it on major selloffs of $10 to $20. Buy silver on selloffs of 20-40 cents."

**JEWELRY:** With my prediction of a global trend to tangible items over from financial items, I thought this was a good time to talk about one of the time-honored stores of wealth -- quality jewelry. The old adage states that the public buys jewelry (particularly gems) at retail and ultimately sells them at wholesale. Believe me, it's true. I don't think there's another area in which the public spends so much money and yet is so ignorant of what it is buying. The sad fact is that an awful lot of the jewelry sold to the public is semi-junk and has shockingly little resale value.

However, you can obtain real value. To do it you must find an honest jeweler who delights in giving "great buys." Such a jeweler is my old friend, D. K. Maltin, located here in La Jolla. D. K. deals in the whole jewelry spectrum -- everything from 22 carat gold bracelets to diamond necklaces to emerald and ruby rings. He has outstanding jewelry at extremely fair prices. D. K. also makes jewelry to order (your design or his), and he makes it right in his own shop. Therefore, when you're in La Jolla my suggestion is to drop in at D. K. Maltin's at 7854 Girard Street -- (619) 454-0472, look over what D. K. has or tell him what you want (he can get it for you or he'll make it for you, and the price will be right). You can also deal with D. K. by phone or mail. By the way, I make not

a cent on anything you buy from D. K. -- or anyone else, for that matter. I just feel I'm doing my subscribers a good turn by directing them to D. K. Maltin, the "Merchant Prince of La Jolla" (just kidding, D. K.), a great guy (and a real character) and a jeweler who offers top-quality merchandise at what I call "the right price."

**NOTES & QUOTES:** US national debt one year ago: $3.982 trillion. Last week's figure: $4.336 trillion. Additions to the national debt over the last 12 months -- $354 billion. That's the REAL federal deficit, and everything else your government tells you is a lie. Fact: we're overspending at the rate of $1 billion a day, 365 days a year. What's this tell us about the future? "We're seeing the future, stupid, and the future is INFLATION." Oops, sorry, Mr. Greenspan, I didn't mean to upset you.

* *

My thanks to Mark Hulbert for the kind comment about your editor in the current issue of *Forbes*. Also, my thanks to Yale Hirsch for dedicating the current issue of his famous *"Stock Trader's Almanac"* to those three "grey beards," Jim Dines, Joe Granville and again your editor. Actually, add Marty Zweig and Harry Schultz and you have five guys who all started their reports in the early 1960s (actually, I started Dow Theory Letters a few years earlier in 1958). The business was entirely different in those days. Then we wrote about the stock market and that was about it. Now you write about everything from commodities to bonds to the currencies to the price of oil. I doubt if any of the five of us would have believed, back in the 60s, that we'd still be at it in 1993. But the markets get in your blood. Market-itis is a disease with no known cure.

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*Sindlinger* & Co. (often quoted here) is a private research company, and it's probably the best antidote to the US government's suspect figures. *Sindlinger* obtains his information via weekly phone quizzes to thousands of households located across the US. *Sindlinger's* latest FAX reports that the "unemployment rate holds at 10.3%," and "households' annual cost of living holds at 9.2%, despite better looking government numbers."

*Sindlinger* notes, "The Bureau of Labor Statistics publishes a broader unemployment measure that receives virtually no coverage in the financial press. Called 'U-7,' it takes some account of discouraged workers and part-time employment. Seasonally adjusted, the BLS' June U-7 unemployment rate was 10.4%." As to the difference between *Sindlinger's* cost of living (inflation) figures and the government's, *Sindlinger* states that his figures take into account the cost of local taxes and insurance, which the government, for some reason, leaves out.

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These Letters don't go out to government bureaucrats, they go out to real people. And real people tell you what's really going on. Here's part of a letter I just received from subscriber R. W. in Esmond, North Dakota. "I got a kick out of your last Letter when you spoke of South Dakota having a long winter. You're right! But up here in N. Dakota the winters are even longer. I farm a ranch here in ND and you wouldn't believe how low our margin of profit is out here. Farmers going broke every day! The price we get for our commodities is about the same as it was 20 years ago. Yet the price of our equipment sure as hell isn't. That stuff is going up about 8% to 9% a year. When the government reports inflation at 4%, I would like to know where. I believe you and Sindlinger -- inflation is about 10%."

And from a subscriber from Australia comes a letter pointing to a quote from Galbraith's "The Great Crash": "During 1928 an estimated 186 Investment Trusts were organized. By the early months of 1929 they were being promoted at the rate of approximately one each business day. In 1927 the trusts sold to the public $400 million. In 1929 they marketed $3 billion." Russell comment: Sound familiar?

* *

Just as governments see inflation as their savior, the various states see gambling income as their salvation. Almost every state in the US has now legalized gambling or is thinking about it. This may not be jeopardizing Las Vegas (which has turned into a big family-oriented playground), but it is worrying Atlantic City. In fact, Donald Trump, whose three casinos make him the biggest operator in Atlantic City, has filed a legal action against the US federal government seeking to block the phenomenal spread of casinos on Indian land. According to *Gaming and Wagering Business* magazine, gamblers bet $331 billion last year, an 8.4% jump over 1991. Half that amount was wagered in Las Vegas while 22% was wagered in Atlantic City. Lotteries accounted for $24 billion or 7%, while $15 billion or 4.6% came from riverboat gambling. Of course, private gambling (which has to be huge) was not figured in.

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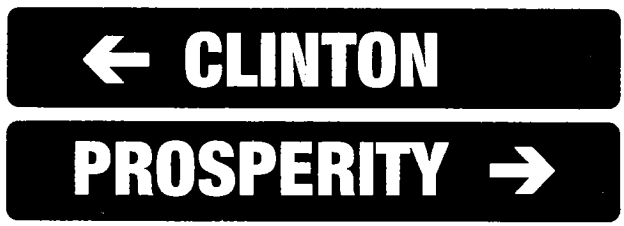
One of my subscribers sent me this bumper sticker. It compresses an awful lot of meaning into two words and a couple of arrows.

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The battle for the survival of the European Rate System and a single European currency climaxes. Last week the system went into crisis mode -- FOREX (foreign exchange) traders sold the French franc as it slid to the bottom of the band against the D-mark. Also attacked by the FOREX people were the Belgian franc, the Spanish peseta and the Portuguese escudo. The Bundesbank spent a whopping $36 billion in an attempt to hold up the weak currencies.

FOREX traders were widely blamed for triggering the crisis. The charge makes as much sense as blaming short sellers and traders for knocking IBM down over the last month. The FOREX traders do their buying and selling based on what they see as either fundamental strength or weakness in specific currencies.

The latest crisis was triggered when the Bundesbank announced a "non-event." The bank lowered the Lombard rate (the highest rate charged by the banks) but failed to lower the more important discount rate. Thus, the Bundesbank held to its anti-inflation, high interest rate stance. This made the D-mark more desirable (rate-wise) than the franc and most other European currencies. Consequently, the traders sold the other currencies.

The fact is that the various nations of Europe have vastly different economies and vastly different rate needs. For this reason, a single European currencies doesn't make sense. This is the basic problem with the ERM, and the quest for a single European currency.

Over the weekend the ERM nations "threw in the towel" by allowing all the currencies (except the D-mark and the Dutch guilder) to fluctuate in a very wide 15% band. This was a polite way of saying that these currencies are devaluing and that the ERM has effectively ceased to be.

In the face of the weekend's monetary chaos, frightened investors rushed into the "money haven" currencies, the dollar and the yen -- and, of course, the ultimate money -- GOLD. The wave of the future? It's clear -- paper currencies around the world losing their purchasing power.

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Daniel Boorstin, the Pulitzer prize winning historian, states that the Constitution is the fundamental American institution. He calls it "the oldest written constitution in use and the greatest piece of political technology that was ever accomplished." Boorstin adds, "We often forget that the oath of the President is the only ceremony prescribed in our Constitution and the only ritual we have in the United States -- the oath to protect, preserve and defend the Constitution."

* *

Who said you can't buy social standing? I was fascinated by this ad that was buried in the financial section of the July 25 *NY Times*.

Nickleby & Company
Land and Title Merchants
(Trading in Estate Since 1866)

**2 BRITISH LORDSHIPS OF THE MANOR FOR SALE**

*We are now able to offer these two very rare and valuable British titles for immediate sale. Included are the rights as laid down by Act of Parliament , and privileges enabling purchasers to open many social and professional doors. Over 1000 years old, they are amongst the oldest Titles in the world , and offer an assured investment opportunity. No other acquisition guarantees such esteemed and respected personal status, whilst according the purchaser excellent international business advantages.*
*This exclusive and prestigious opening is available to persons of good standing and of any Nationality. The prices of the Lordships are US$ 19,850, and US$ 24,600, inclusive of all legal fees and transfer costs. Both Lordships come with full legal documentation. If you wish to consider buying a piece of British History, tradition and heritage, whilst enjoying the benefits of the ultimate status symbol, please fax us in London, England, for further information.*

**Facsimile: 011 44 81 838 2788**

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People who are studying or trying to clean up the mess left by communism are still amazed by the total inefficiency and deceit of the communist system. The system works about like this: (1) There is no unemployment, but no one works; (2) No one works, but everyone gets paid; (3) Everyone gets paid, but there is nothing to buy; (4) No one can buy anything, but everyone owns everything; (5) Everyone owns everything, but no one is satisfied; (6) No one is satisfied, but 99% of the people vote for the system. Russell comment: What really was going on under communism? Answer: The entire system was a lie, but hundreds of millions of people went along with it. Conclusion: the only real power evil (i.e., a lie) possesses is the power to ultimately destroy itself.

* *

Barry Diller (who set up the FOX network) is no fool. In taking over QVC and then merging it with Home Shopping Network, Diller has laid the foundation for a new way of shopping and another new network. Will people shop via TV? Is this the future of retailing? Personally, I won't do it, but it could be the wave of the future. Here's why. It's becoming less and less attractive to live in or even near big cities. The national trend is to move out of the cities, and even away from the suburbs. With today's great communication facilities, a great many businesses can operate almost anywhere. So what's the wave of the future? Shopping by TV by families located in small, even isolated, towns all over America.

* *

The money supply figures continues to puzzle both Wall Street and the Fed. Despite frantic efforts to "pump up the volume," the Fed's efforts, so far, have failed to show up in the broad money supply figures. One theory (which deserves a lot of credence) is that the massive amounts of cash going into stock and bond mutual funds (actually, around $20 billion a month) have thrown off the broader (i.e., M-2, M-3, M-4) money supply figures. Mutual fund totals do not appear as part the nation's money supply, despite the fact that the funds have absorbed a massive amount of money.

Question: What do you do if the statistics you're using don't give you the results that you want? Answer: Just use different statistics. So saying, a frustrated Alan Greenspan announced to the House Banking Committee that hence forth the Fed would base its manipulations on interest rates rather than the money supply. As for M-2, Greenspan simply mumbled that it has ceased to work as a reliable indicator.

* *

I've written about this many times, but it's worth noting that over the past twelve months the Fed has bought $38 billion of Treasury debt. This is known as monetizing, since the Fed buys the debt from bond dealers (i.e., the banks) and then simply credits the bank with the sales, thus creating mountains of new dollar deposits "out of thin air." Yet, two weeks ago Greenspan told the House Banking Committee that he was "disappointed" with the inflation picture. C'mon, Alan, get real -- if you're not happy with the inflation picture, stop inflating.

* *

In 1997 China takes over control of Hong Kong from the British. Nobody knows exactly how this will work out. Hong Kong remains a chief source of hard currency for the Chinese, and the Chinese definitely need hard currency. For this reason, many observers believe that China will leave Hong Kong largely alone (under the thesis that "money conquers all"). But then there is the other side -- those who believe that China's leaders will be threatened by the "disease of Democracy", which may be exported out of Hong Kong. At any rate, I noticed this little piece from the *International Herald Tribune*. When the chips are down, China's leaders undoubtedly believe that ultimate authority stems from the barrel of a gun.

**Beijing Readies Army for Hong Kong**

***Preparing for 1997, China Trains Force For Duty in Center***

By Kevin Murphy
*International Herald Tribune*

HONG KONG — Specially trained People's Liberation Army units will be deployed in central Hong Kong areas soon after the British colony reverts to Chinese rule in 1997, a senior Chinese military official said Friday in Beijing.
China's first public disclosure of its mil-

* *

In the last Letter I opined that with the trend away from financial assets and into tangibles, maybe even the collectibles will make a return visit. You remember that a few of the central banks sold gold early in the year -- right at the bottom. That was excellent ammunition for those who believe in contrary opinion. Here's more contrary opinion ammunition. Back in 1988 Merrill Lynch started a $25 million rare coin fund, Athena II. The fund sold shares to investors at $1,000 per unit, after taking off a fat 18% for commissions and fees. Two weeks ago Merrill threw in the sponge and announced that it was going to auction off its rare coins. Is the bull market in rare coins about to begin?

* *

Dan Rostenkowski (D-Ill), a classic Chicago machine politician, is accused of embezzling money from the Congressional post office, specifically, about $21,000. This is the guy who decides how much taxes I pay? When questioned at first, Rosty took the Fifth. But wait, now he says he's innocent. Larry King says, "If he wants me as a character witness, I'll be there." Yah, that should be a big help.

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A new book about General Norman Schwarzkopf, "Crusade, the Untold Story of the Persian Gulf War," by a *Washington Post* reporter tells us that Normy was not loved (to say the least) by his underlings. In fact, Cheney considered firing the General because of his wild temper and "imperial trappings" (Normy traveled with an extensive motorcade and demanded a setting of O. J., coffee, water and chocolate mocha wherever he went). Russell comment: from the looks of him, the chocolate mocha won out.

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If you live in Southern California you are very aware of the illegal alien problem. They are here by the tens of thousands. Here's how *USA Today* put it: "The latest round of recriminations has been prompted, at least in part, by recent headlines: boatloads of Chinese peasants trying to sneak in to US ports; Haitians with AIDS virus ordered in; immigrants arrested in connection with the New York bomb plots; an Egyptian cleric who somehow got in and now can't be immediately kicked out. One side says the US -- especially California, Texas, Florida and New York -- is being invaded by immigrants who crowd neighborhoods, take jobs, cost money and change the culture." Here in California it is estimated that medical care for aliens is costing the state over one billion dollars a year.

* *

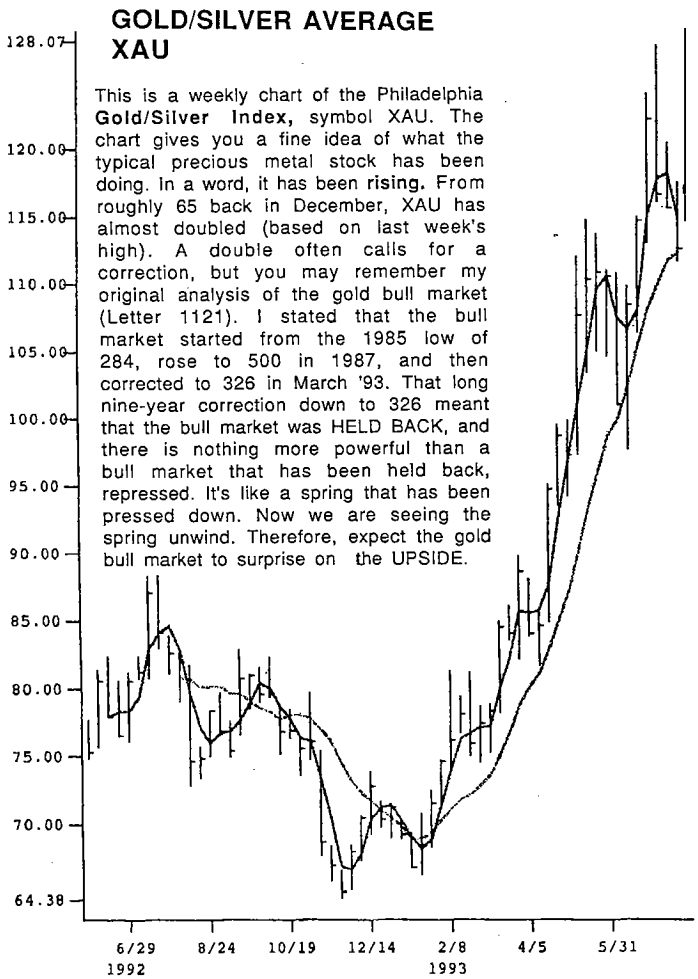
There's got to be money in Russia. Rolls Royce (which is now up for sale) has sold 60 of the over $138,000 cars to various people in Russia. But Rolls is hurting: in 1990 they sold 3,333 of their expensive beauties, but last year that number dropped to 1,378.

* *

Is another big federal bailout coming? Nicholas Retsinas, commissioner of the Federal Housing Administration says, "We're sitting on a time bomb." How come? Well, the latest count from the FHA estimates that the FHA multifamily loss reserve is at $11.9 billion, equal to 27% of the entire $43.6 billion in FHA-insured multifamily mortgages now outstanding. Russell comment: Ah well, $11 billion isn't really that much. Then again, it buys a lot of Big Macs.

* *

Of the first six paperback top sellers listed by the *NY Times*, I am amazed to see that three were written by John Grisham (The Firm, The Pelican Brief, A Time to Kill), and three were written by Michael Crichton (Jurassic Park, Rising Sun, Congo). These two guys can get three million bucks and up for just giving a publisher the rough outline of their next book. Ah yes, there's nothing like a real professional!


GOLD/SILVER AVERAGE
XAU
This is a weekly chart of the Philadelphia Gold/Silver Index, symbol XAU. The chart gives you a fine idea of what the typical precious metal stock has been doing. In a word, it has been rising. From roughly 65 back in December, XAU has almost doubled (based on last week's high). A double often calls for a correction, but you may remember my original analysis of the gold bull market (Letter 1121). I stated that the bull market started from the 1985 low of 284, rose to 500 in 1987, and then corrected to 326 in March '93. That long nine-year correction down to 326 meant that the bull market was HELD BACK, and there is nothing more powerful than a bull market that has been held back, repressed. It's like a spring that has been pressed down. Now we are seeing the spring unwind. Therefore, expect the gold bull market to surprise on the UPSIDE.
128.07
120.00
115.00
110.00
105.00
100.00
95.00
90.00
85.00
80.00
75.00
70.00
64.38
6/29
1992
8/24
10/19
12/14
2/8
1993
4/5
5/31

**GOLD:** The central banks' banker is Michael Camdessus, managing director of the International Monetary Fund (IMF). Last week he came out with an extremely bullish statement about gold (his statement was probably issued for the edification of the world's central banks). Said Mr. Camdessus: *"The gold of the IMF fund is the strength of the institution, and we have to think twice before diverting it to other purposes. Who can tell us what the situation will be at the beginning of the next century when the world will need a still stronger fund?"*

The MAJOR socio-economic trend of today is the movement of almost all the formerly communist nations to free markets and capitalist economies. If there's one thing capitalism needs, it's capital; in other words, these new capitalist nations need increasing quantities of MONEY. Therefore, it's clear that if the world is to pull itself out of its current malaise, it must generate money -- a lot of it. That's a polite way of saying that nations MUST inflate. But there's another incentive to inflate -- the incentive is that inflation reduces the pressure of debt (and, of course, almost every nation is now carrying heavy debt).

This enormous need for money is calculated to do two things: (1) push up the rental price of money, and the rental price of money is expressed in interest rates, and (2) greatly increase the ratio of paper money to gold, thereby putting upside pressure on gold.

Now a bit of history and a prediction: in 1980 the price of gold crossed with the price of the Dow. Gold rose to 850 in 1980 and the Dow hit a low of 759.13 on November 20 of that year. The question: can it happen again? With the Dow now at around 3500 and gold at 392, will the two cross again? I believe that somewhere during the next two to five years they will cross. And if they do cross, will it be the Dow collapsing or will it be gold exploding higher? I think it will be both, but I'll stick to my prediction -- somewhere ahead (incredible as it now seems) we'll see the two cross again.

I don't often agree with editor and publisher Malcolm Forbes Jr. but I thought this editorial from the current issue of *Forbes* magazine was a beaut: *"Unless the burden on capital gains is reduced or eliminated, whatever tax bill Congress passes will hurt the economy. Annual growth will be lucky to touch 2%. Depending on legislative details, a recession could result. As the baleful impact of the package becomes apparent, the White House will put intense pressure, rather than the so far gentle pressure, on the Fed to prime the economy through easy (read inflationary) credit. Greenspan and his colleagues will resist. We will have a confrontation like that between Harry Truman and the Fed over 40 years ago. Truman ousted the chairman, but the Fed still raised the rates.*

*"No matter the outcome of this coming battle, which will begin in earnest by year's end, you can bet that bonds will be beaten while the fight rages. That's why gold's price is going up -- in anticipation of inflationary and other kinds of fireworks to come."*

Meanwhile, almost everyone (including even the gold-bugs) have been predicting or waiting for a correction in gold. The gold bull market has not obliged. True, many of the gold stocks backed off up to 10%, but as of late last week almost all gold shares were near their highs or at new highs.

From the metal's standpoint, the picture is clear. The major target for gold has been for the metal to climb **above 400** (maybe to 410-420), then consolidate and hold stubbornly above 400. Once gold can push above 400 and remain decisively above 400, the next major target becomes the next big even number -- 500. On Friday, July 30, gold closed at 409. This is a major technical achievement for the gold bull market.

But remember, we are still in the early stage of the gold rise. This is the erratic stage, the difficult stage. Now consider this -- you could buy up **ALL** the stock in all the major gold companies for around $40 billion. That equals exactly 40 days worth of US federal deficits. Here's another thought -- suppose 15 or 20 large mutual funds decide to take say a small position, say a 2% or 3% position in gold shares?

Gold stocks I like -- Placer Dome, Amer. Barrick, Pegasus, Echo Bay, Homestake (HM), Hemlo, Newmont Mining, Newmont Gold, Lac, Agnico Eagle, Royal Oak, Cambior (Montreal). By the way, HM is not the "stodgy" producer of old. Besides its US mines, HM now has mines in Australia and Canada plus 14 smaller mines in sundry places. HM's average gold production cost is now down to around $248 (based on 1992 figures).

**LATE NOTES:** You have to wonder how long gold and bonds can keep going up together. Historically, the two are enemies, but there's a difference today. Bonds are rising because of the perception that there's little inflation (although some say that bonds are rising because the Fed is buying them en masse). And gold? Gold may be going up, not so much as a reflection of inflation, but because the world trusts paper currencies less and less (and also, of course, because there's tremendous worldwide buying of gold jewelry and gold coins, and not just on the part of Asia) . . . As for the stock market, it continues to push higher. But personally, I'd rather be in the new bull market (gold) than I would in the ancient bull market (stocks). Bonds, I think the rise looks "tired" . . . On Friday, July 30, Bill Gates' holdings of Microsoft dropped $396 million in value. Instead of a steak dinner that night, Bill probably had a hamburger.

NEXT MAILING: Aug. 18, 1993